



New Issue: MOODY'S ASSIGNS Aaa RATINGS TO IOWA FINANCE AUTHORITY STATE REVOLVING FUND REVENUE BONDS, SERIES 2010A AND STATE REVOLVING FUND REVENUE BONDS TAXABLE SERIES 2010B (BUILD AMERICA BONDS - DIRECT PAYMENT)

Global Credit Research - 04 Nov 2010

Outlook is stable; approximately \$480.4 million in outstanding debt affected

Iowa Finance Authority State Revolving Fund
State Revolving Funds
IA

Moody's Rating

ISSUE

RATING

State Revolving Fund Revenue Bonds, Series 2010A

Aaa

Sale Amount \$89,870,000

Expected Sale Date 11/09/10

Rating Description Revenue

State Revolving Fund Revenue Bonds, Taxable Series 2010B (Build America Bonds - Direct Payment) Aaa

Sale Amount \$203,185,000

Expected Sale Date 11/09/10

Rating Description Revenue

Opinion

NEW YORK, Nov 4, 2010 -- Moody's Investors Service has assigned a Aaa rating to Iowa Finance Authority's Iowa State Revolving Fund Revenue Bonds, Series 2010A and State Revolving Fund Revenue Bonds, Taxable Series 2010B (the "2010 Bonds"). The outlook is stable. We have also affirmed Aaa ratings on all of Iowa Finance Authority's State Revolving Fund Revenue Bonds (the "Existing Bonds").

SECOND AMENDMENT OF MASTER TRUST AGREEMENT:

Existing Bonds Master Trust Estate - Iowa Finance Authority (IFA) has entered into a second amendment to the Master Trust Agreement on November 1, 2010. As a result, any series of bonds issued prior to the date of the amended Master Trust Agreement will benefit from the Existing Bonds Master Trust Estate which include (1) amounts transferred from each Existing Bonds to the Deficiency Fund, (2) amounts payable on SRF loans evidenced by participation agreements pledged to Existing Bonds, excluding initiation fees and servicing fees, and (3) securities and investment earnings on moneys, including Debt Service Reserves, pledged to pay debt service on Existing Bonds.

Open Security Master Trust Estate - Any series of bonds issued on or after November 1, 2010 will benefit from the Open Security Master Trust Estate which consists of all moneys, securities, investments and participation agreements pledged to the Master Trust Agreement (excluding amounts pledged to Existing Bonds Master Trust Estate). However, when a particular series of Existing Bonds is no longer outstanding, the related Participation Agreements and securities will be pledged to the Master Trust Agreement. Furthermore, on each interest payment date, amounts on deposit in the Deficiency Fund in excess of paying debt service and replenishing reserves of the Existing Bonds will be transferred to the Equity Fund which is pledged to the Master Trust Estate. Amounts on deposit in the Equity Fund may be used to make or purchase loans, pay debt service of all bonds and provide subsidies and assistance.

New bonds issued pursuant to the amended and restated Master Trust Agreement will no longer be separately secured within closed trusts but will be secured by an open Master Trust Estate.

RATINGS RATIONALE

LEGAL SECURITY: The Existing Bonds are limited obligations of IFA secured by the entire Master Trust Estate consisting of the Existing Bonds Master Trust Estate and the Open Security Master Trust Estate. Each separately-secured series of bonds is linked through the Deficiency Fund under the Master Trust Agreement.

The 2010 Bonds are also limited obligations of IFA secured solely by the Open Security Master Trust Estate. The 2010 Bonds are not secured by revenues pledged to Existing Bonds until such revenues have been transferred from the Deficiency Fund to the Equity Fund.

Generally, State Match bonds, which provide the state matching funds required to access federal capitalization grants, are secured by loan interest payments made from borrowers pursuant to participant agreements, investment earnings and debt service reserve funds; leverage bonds are secured by loan principal payments and excess interest payments and investment earnings not needed for state match bond debt service and debt service reserve funds; amounts held in the Equity Fund are also pledged pursuant to the Master Trust Agreement.

USE OF PROCEEDS: Proceeds of the 2010 Bonds are expected to be used for (1) financing loans under the SRF program, (2) refunding a portion of Existing Bonds (a portion of 2001 Series and 2003 Series) and (3) paying for costs associated with the issuance of 2010 Bonds. Approximately \$131 million of proceeds are expected to be deposited into Equity Fund and be used to reimburse IFA for prior loan disbursement.

INTEREST RATE DERIVATIVES: None

STRENGTHS:

- * Large and diverse pool of borrowers, with an average credit quality of A3
- * The program will be able to meet its debt service obligation even after a significant, but highly unlikely, 35.3% default of pledged loans through final maturity
- * Each separately secured series of Existing Bonds is linked through the Deficiency Fund under the Master Trust Agreement
- * Water Pollution Control Works (CW) and Drinking Water Facilities Financing (DW) Programs are cross-collateralized through the Deficiency Fund created under the Master Trust Agreement
- * In connection with the new issue, IFA expects to pledge an additional \$413.5 million of loans to the Open Security Master Trust Estate.
- * Prior to the effective date of second amendment of Master Trust Agreement, surplus funds not needed to cure a deficiency flow to the Equity Fund (not pledged), and can be used to make loans which are not pledged to the repayment of the bonds. The Equity Fund is now pledged to the Master Trust Estate.

CHALLENGES:

*De-pledging of loans securing the bonds is allowed upon certification of sufficient coverage of debt service; pre-payments of loans are also allowed, at management's discretion

*There are no minimum coverage requirements provided for in the Master Trust Agreement other than 1.05x coverage requirement for additional parity bond issuance (1.10x for additional subordinate bond issuance) and 1.20x coverage requirement for withdrawing funds

LARGE, DIVERSE POOL OF BORROWERS EXHIBITS AVERAGE CREDIT QUALITY

The program's size and diversity is an important factor supporting the Aaa rating. The majority of the pledged loans are secured with a first lien on net revenues of the borrower's utility system. The bonds issued by program participants to evidence their loans include rate covenants requiring net revenues to cover senior lien debt service by 1.10x (for senior lien loan pledge) or to cover aggregate debt service by 1.05x (for combined senior and subordinate lien loan pledge). A general obligation pledge is provided by a limited number of borrowers.

The combined loan pool includes a sizable 511 borrowers, with no significant concentration in any single borrower. The portfolio has been growing and its diversity is an important credit factor. The top 5 borrowers represent 27% of the outstanding loans; however, 55% of the total loans outstanding have loans comprising less than 1% of the total loan portfolio. Moody's internal assessment of the borrowers' credit quality indicates that the average borrower rating is in the A category.

RESERVES AND CASH FLOW FROM LOANS PROVIDE SUBSIDY AND SECURITY

The solid reserve levels along with the cash flow from participant loans are critical to the rating. The amount of loans outstanding substantially exceeds the amount of bonds outstanding, which together with investment earnings and reserves, provide security to bondholders.

Total pledged reserves for both CW and DW programs, coupled with reserves in the Equity Fund, are \$88.7 million after this issuance, or 12% of total bonds including the new issuance. Reserves for bonds issued prior to 2004 were sized at 50% of bond principal (DW) or 30% of bond principal (CW) and were funded through federal capitalization grants, generating investment earnings which subsidize a portion of the participants' loan interest rate. Since 2004, reserves have been sized at the lesser of MADS, 125% of average annual debt service, or 10% of outstanding par and funded by bond proceeds. However, there will be no reserves funded in connection with the 2010 Bonds.

In addition, bonds are secured by an oversized pool of loans; after the current issue, \$1.189 billion of loans will be pledged to \$717.5 million of bonds. The lowest combined debt service coverage from both loan repayments and investment earnings is expected to be 1.23x for all bonds and 1.09x for the bonds issued post the second amendment of the Master Trust Agreement. The program also has a high default tolerance of 35.3%. There has never been a participant default in either program in its nearly 20 year history.

PROGRAM STRUCTURE: Each series of Existing Bonds is separately secured and there is no minimum reserve requirement, or debt service coverage requirements. Each series of bonds is linked through a Master Trust Agreement: as reserves are de-allocated in proportion to bond principal amortization, the freed up reserves are available to cure a default in any leverage bond issued under the indenture. Excess loan repayments not needed for debt service flow to either the interest or principal sub-account of the Deficiency Fund. Interest sub-account funds are available to pay state match bond debt service and all deficiency funds are available to pay debt service on leverage bonds. Amounts not needed to cure a deficiency flow to the Equity Fund and are available to make new loans. However, Equity Fund is not pledged to the Existing Bond Master Trust Estate. Additionally, while the drinking water and water pollution control programs are also separate, de-allocated reserves not needed to cover deficiencies for one program are available to cure a default in the other program (cross-collateralization).

New bonds issued pursuant to the amended and restated Master Trust Agreement will no longer be separately secured within closed trusts but will be secured by an open Master Trust Estate. Amounts not needed to cure a deficiency will continue to flow to the Equity Fund and be available for new loan origination or pay debt service on all outstanding bonds. Equity Fund is pledged to the Master Trust Estate.

ESTABLISHED AUTHORITY MANAGEMENT JOINTLY ADMINISTERS PROGRAM WITH DEPARTMENT OF NATURAL RESOURCES

The CW was established in 1988 pursuant to the federal Clean Water Act and the DW program was established in 1997 pursuant the federal Safe Drinking Water Act. The authority administers the Water Pollution Control Works and Drinking Water Facilities Financing Program in cooperation with the Iowa Department of Natural Resources (DNR). The authority is responsible for underwriting loans, issuing debt and disbursing funds to borrowers, while the DNR concentrates on technical support, and construction monitoring of projects funded through the SRF programs. Loan repayments are due two months prior to debt service payment dates, providing the authority with ample timing to address any delinquencies. With the first amendment of the Master Trust Agreement, IFA shifted financial management responsibility solely to itself (previously the authority shared these responsibilities with DNR). This change is expected to streamline operations allowing DNR to concentrate on environmental management and the authority to focus on financial management of the SRF programs.

The principal methodology used in this rating was U.S. State Revolving Fund Debt published in September 2010.

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings.

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Outlook

The stable outlook is based on the expectation that the sizable reserves and cash flows, and average credit quality and substantial diversity of borrowers will be maintained.

What Could Change the Rating - UP

-None

What Could Change the Rating - DOWN

-Increased leveraging of the program, resulting in a significant decrease in debt service coverage or the default tolerances can place downward pressure on the rating

-A material change in the credit quality of the pool participants can also cause a rating downgrade.

KEY INDICATORS (as of 10/22/10 unless otherwise noted):

LOAN TYPE: Clean Water and Drinking Water

FUND STRUCTURE: Hybrid - Reserve and Cash Flow Model

MINIMUM PROJECTED BOND COVERAGE: 1.23x for both the Existing Bonds and 2010 Bonds; 1.09x for the 2010 Bonds

VARIABLE RATE AS A % OF OUTSTANDING DEBT: None

TOTAL BONDS OUTSTANDING: \$480.445 million; \$717.47 million following this issuance

TOTAL LOANS OUTSTANDING: \$774.7 million (not including \$413.5 million in loans to be pledged to the Open Security Master Trust Estate); \$1.189 billion following this issuance

LOAN PLEDGE: primarily net revenues of utility systems with 1.10x rate covenant; limited number of GO pledges provided

ASSET-TO-LIABILITY RATIOS:

"1.80x (\$480.445 million of bonds secured by \$774.7 million of loans and \$88.7 million of reserves);

"1.86x after the issuance of 2010 Bonds (\$717.47 million of bonds secured by \$1.189 billion of loans and \$143.557 million of investments in the Reserve Fund and Equity Fund)

NUMBER OF TOTAL BORROWERS: 551

% OF TOP FIVE BORROWERS: 27%

% OF BORROWERS HOLDING LESS THAN 1% OF THE PORTFOLIO: 55%

WEIGHTED AVERAGE PORTFOLIO CREDIT QUALITY: A3

DEFAULT TOLERANCE: 35.3% (does not include BAB reimbursements or interest earnings on reserves); compared to 31.2% in November 2009

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